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Supreme Court of the United States

OCTOBER TERM, 1953

No. 423

LLOYD M. BENTSEN., et al, *Petitioners*
v.
EMERY C. BLACKWELL, et al, *Respondents*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR RESPONDENTS

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BRIEF FOR RESPONDENTS

OPINIONS BELOW

The brief of Petitioners correctly states that the opinion of the District Court (R. 34-36) has not been officially reported, and that the opinion of the Court of Appeals (R. 50-54) is reported in 203 F. 2d 690.

JURISDICTION

The brief of Petitioners correctly states that judgment of the Court of Appeals was entered on April 27, 1953 (R. 55); that petitions for rehearing were denied on July 27, 1953 (R. 55); that petition for writ of certiorari was filed in this Court on October 21, 1953, and granted on December 7, 1953.

QUESTION PRESENTED

Here Respondents part company with Petitioners. The question as presented by Petitioners is so loaded with argument, as to be of no value as a question.[1] The question to be decided by this Court is whether oral communications containing false and fraudulent statements inducing the investment are required to be transmitted across a state line, where the mails are used after the signing of an executory contract to complete the transaction (by delivery of the deed, care contract, care statements inducing additional investments, and guarantee title policy[2]), to make Section 12 (2) of the Securities Act of 1933 available to a defrauded investor, as a means of relief.

Also, alternatively, if Respondents are not entitled to the relief provided under Section 12 (2), then can jurisdiction be maintained under Section 17 (a) (R 2, 13)?

STATUTES INVOLVED

Section 12 (2) of the Securities Act of 1933, as amended, 15 U.S.C. Sec. 77 1 (2) reads as follows:

"Any person who—

* * * * *

sells a security (whether or not exempted by the provisions of section 3, other than

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[1] Note the use of the words, "local land dispute," "purchasers of citrus land in the Rio Grande Valley of Texas", "seek to invoke", "purely intrastate transaction", "where sale is completed without use of the mails or interstate commerce" and "executed documents evidencing a completed transaction", which in each case ask the Court to presume matters hotly contested in the pleadings herein, as will be apparent from further reading herein.

[2] The pleadings do not make special issue of the delivery of the guarantee title policy through the mails, though it will be shown at the trial that the promise of such delivery through the mails was a vital inducement to the investor to part with his money without first consulting an attorney.

paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

Section 17 (a) (2) of the Securities Act of 1933, as amended, 15 U.S.C. Sec. 77q (a) (2) reads as follows:

(a) It shall be unlawful for any person in the sale of any securities by the use of any means or instrumets of transportation or communication in interstate commerce or by use of the mails, directly or indirectly—

(1) * * * *

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in

order to make the statements made, in the light of the circumstances under which they were made, not misleading, or - - - -

Sections 2(3), 5(a) and (b), 13 and 15 are set out in the Appendix to this brief.

STATEMENT OF THE CASE

This action was originated in the United States District Court for the Southern District of Texas, Brownsville Division, by eight resident plaintiffs against these three Petitioners and twelve other corporate and individual defendants, all residents of Texas, (R. 1). The eight plaintiffs and a later intervenor (R. 26, 28) sought relief under the Securities Act of 1933 for cancellation and rescission or damages resulting from their purchase from defendant, Pummill Development Company and Pummill Management Company, of certain investment contracts in the form of contracts for sale of land, coupled with contracts for planting of said land to citrus trees and for care and management of such land and trees until maturity, and thereafter, with the purchasers to return to the place of their residence and do nothing further than meet the care bills as they came in through the mails, and ultimately reap the dividends or benefits of the investment. (R. 1, 3-10, 16, 29-33).

Respondents, on various dates from November 23, 1949 through March 3, 1950, purchased the alleged investment contracts, which consisted of a deed to land in Hidalgo County, Texas, coupled with a care or management contract providing for the setting of the land to citrus trees and the care and management of such citrus development. The deed was from

Pummill Development Company, and the care contract with Pummill Management Company, which companies had identical stockholders and officers. (R. 1-10, 26-28). Seven of such Respondents received deeds to twenty acres of land each, (R. 3, 5-6-7-8-9-10), one to forty acres, (R. 27), and another to eighty acres, (R. 4). Four of Respondents are wheat farmers from Northwest Texas, one a cotton farmer from Greenville, Texas, one an engineer from Wisconsin, who moved to Texas after the purchase, one is a merchant from North Texas, and two are merchants from Central Texas. None of Respondents lived in, nor were familiar with the citrus producing area of Texas at the time of the purchases, and all looked upon the transaction as an investment, as it was represented to them to be. None bought with the intention of personal management, but each relied upon the management of Pummill Management Company under the management contract. (R. 2, 3-10, 26-28).

Petitioners acquired title to an 800-acre tract of dry land worth approximately $50.00 per acre, and conveyed such land (less minerals) to the insolvent Pummill Development Company for nothing down, and a mortgage $100,000.00 in excess of the actual value of the land.[3] (R. 2, 13). This transaction gave petitioners control of the entire operation, forced Pummill Development Company to sell the land at prices still higher above the actual value of the land, and removed Petitioners one corporation (and a few brokers, etc.), further from the defrauded investors.

[3] It will be shown on trial that Petitioners have foreclosed on all, or substantially all, of the assets of Pummill Development Company, and Pummill Management Company, thus confirming Respondent's contentions of insolvency of the selling group and control by Petitioners.

(R. 2, 13). Thus the 800-acre tract could be uniformly developed as a unit, and offered for sale in small acreages with care and management contracts to investors, in the same manner as any other new issue of securities, at prices absorbing a pro-rata part of the original cost of the land plus the amount that was necessarily added as profit for Pummill Development Company.[4] (R. 2, 13, 14).

Respondents contend that their investments were induced by false and fraudulent oral representations and concealments made by brokers, officers, agents and employees of Pummill Development Company, and that continuing investments in care were induced by written fraudulent statements transmitted to Respondents through the United States Mails by both Pummill Management Company and Pummill Development Company, their officers and employees. (R. 2, 3-10, 10-15).

The division of labor involved in the selling operation was: (1) the broker's job was to find the prospect and bring him to the Clubhouse office of Pummill Development Company in the Rio Grande Valley of Texas; (2) there the officers and employees of said company would take over and complete the selling procedure with continued cooperation of the broker. (R. 2, 14, 15). An executory contract was signed and the investor's money taken in face to face negotiations at such time and place. Simultaneously it was agreed that the U. S. mails would be used to complete the transaction. Petitioners in

[4] It will be shown on trial that some of the items of additional cost include a 25% commission to the broker responsible for bringing the prospect to the Clubhouse of the selling group in the Rio Grande Valley, the cost of maintenance and operation of said Clubhouse, its staff of cooks, housekeepers, drivers for tours, and such profit as was calculated for the selling group.

their brief like to use language that the "transactions were thus completely entered into and all agreements made and concluded by face to face personal discussions in Hidalgo County, Texas, without use of the mails or any means of interstate commerce." (Petitioners' Brief, p. 5). Petitioners state as a fact that the transaction is closed when the selling company gets the investors' money or property, while Respondents state as a fact that the deal is not closed until the investor receives what he bought and paid for. These items are delivered to the purchaser through the mails, and include (1) the deed, (2) care or management contract, (3) guarantee title policy on the land,[5] and (4) numerous statements of care expenses, to induce further and continuing investment, which later statements included false and fraudulent matter. (R. 2, 3-10, 14).

The above use of the mails is not the sole basis of jurisdiction claimed by Respondents, as stated in Petitioners' brief (p. 5). Respondents also claim jurisdiction under Section 17 (a) of the Securities Act. (R. 2, 13).

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[5] It will be shown at the trial that the selling methods of Pummill Development Company included keeping the investor at the Clubhouse, some seven miles from the closest town, and isolating him from local prices, local conditions, and local people, for a period of three days, with the 3rd day being set aside for closing. The slightest contact with local real estate dealers, local attorneys, or local people during this closing period might appraise the investor of the true facts, and destroy chances of a sale. The selling company is in a position to tell the prospect that a guarantee title policy, his deed, and care contract will be transmitted to him through the mails, and after taking the investor's money or property, place him in an automobile with the broker who brought him to the Rio Grande Valley where he will be taken straight home hundreds of miles from his investment. This gives the selling company time to clear all checks without danger of the investor learning the true facts. The importance of this use of the mails in perpetration of the fraud cannot be ignored.

THE RULINGS BELOW

The District Court (Allred, J.) dismissed the complaint (R. 46-7) and in his memorandum gave as his reasons: (1) "the transactions alleged do not constitute a 'security' within the meaning of the act"; (R. 38); (2) that the use of the mails involved did not come within the prohibition of Section 12 (2) of the Securities Act, following the reasoning of Kemper v. Lohnes, 7th Cir., 173 F. (2d) 44, and rejecting the doctrine of Schiller v. H. Vaughn Clarke & Co., 2nd Cir., 134 F. (2d) 875, (R. 41-45) and adding this statement:

> "In view of this disposition it is unnecessary to discuss the remaining questions raised by defendants." (R. 45).

Having thus disposed of the case, the Court entered an order of dismissal without discussion of the question of jurisdiction under Section 17(a), which section would have application only if sale of a "security" were involved.

The Court of Appeals, 5th Circuit, reversed on both points, holding the complaint adequately alleged sale of a security, and use of the mails sufficient to bring the case under the provisions of Section 12 (2) of the Securities Act. (R. 50-55). Such holding automatically revived the importance of Section 17 (a) as a jurisdictional basis.

While Certiorari here was sought on the question of construction of Section 12(2), nothing contained in the Courts' Order Allowing Certiorari excluded consideration of the undecided question of the construction of Section 17 (a) of the Securities Act. (R. 56).

SUMMARY OF ARGUMENT

1. Section 12 (2) of the Securities Act gives a civil remedy where the mails are used for transmission of the deeds, care contracts, title policies, and care statements inducing additional investments. This Section does not require that the false statement or fraudulent matter be transmitted through interstate channels as an inducing factor, but only that the mails be used in connection with the transaction. Respondents contest the major premise of Petitioners' brief that the use of the mails in this case was *after* the sale was concluded, and contend that the sale is not "concluded" until the investor gets what he bargained for, which items were delivered through the mails in this case. Nevertheless, *after* the fraudulent sale, use of the mails as here involved is within the prohibitions of the Securities Act, as interpreted by the Court of Appeals, 2d Cir., in Schiller v. H. Vaughn Clarke & Co., 134 (2d) 875, and by the 5th Cir. in Blackwell v. Bentsen, 203 F. (2d) 690. Petitioners' construction of Section 12 (2) would throw this section out of alignment with the interpretation given other sections of the Act, as well as the general purpose of the Act.

2. Respondents are not afforded the relief under Texas Blue Sky laws, nor the common law of fraud, that is afforded by the Securities Act, and even if so, would not thereby be denied specific relief provided by Congress. Where there is an option as to relief available, it is not only the privilege, but the duty of Counsel for the injured party to select the relief which affords the injured party the greater protection. In this case it is the Securities Act in the Federal Courts.

3. Federal Jurisdiction was provided by Congress to give relief to injured parties in cases of this type, and the exercise of such jurisdiction by the Federal Courts is not an "extending" of such jurisdiction. To deny federal jurisdiction here would be a retrenchment from the intent of Congress to stop fraud in sales of securities, and the interpretations of the Courts of such intent.

4. The Congressional purpose in pasing the Securities Act was, among other things, to prevent the use of the mails as an auxiliary to any scheme for fraudulent sale of securities. Such purpose would be served by affirming the judgment of the Court of Appeals.

5. Respondents contend further that they are entitled to relief in the Federal Courts under the provisions of Section 17 (a) of the Securities Act which renders the use of the mails here involved unlawful. The District Court having held no security was sold, did not pass on Section 17 (a); the Court of Appeals in reversing the District Court, held that sale of a security was involved, and that there was sufficient use of the mails to bring the transaction within Section 12 (2), and did not rule as to Section 17 (a). Respondents contend further that if this Court finds no jurisdiction under Section 12 (2), it must rule as to Section 17 (a), in order that justice may be done in this matter, and uncertainty removed from the law.

ARGUMENT

I. The Statutory Language Does Apply to the Facts Pleaded Here

The District Court's memorandum contained a quotation from the brief of Pummill Development

Company, et al, in the District Court, wherein Respondents (Plaintiffs below) were accused of "having read some cases," and then attempting to plead themselves into Federal Court. (Petitioners' Brief, p. 6). Petitioners like to quote this statement, and Respondents like to plead guilty of "having read some cases". The decision of this Court in S.E.C. vs. W. J. Howey Co., 328 US 293, is on all fours with the facts involved in the instant case, with the exception that the Howey Co. was apparently engaged in a good-faith, legitimate operation. The District Court's effort to distinguish it implies a doctrine that if the swindle involves a small amount (one row of trees), it violates the Securities Act, but if a large amount, (20 acres), the Securities Act is impotent. (R. 40).

The petitioners in this case, like the Howey Co., had failed to register their operation with the Securities and Exchange Commission. The plaintiffs-respondents, because of the false reports and statements forwarded to them at their homes in distant parts of Texas by the sellers, remained in ignorance concerning the fraudulent nature of their investment for more than the 12 months limitation period after their purchases to bring action for failure to register, and were forced to bring their suit under Sections 12 (2) and 17 (a) of the Securities Act instead of Section 12 (1), which provides for a private right of action for failure to register the Securities.

Because of the one-year limitation statute applying to Section 12 (1), Respondents read further as to Sections 12 (2) and 17 (a), and found that the Second Circuit Court in the case of Schillner vs. H. Vaughan Clarke, 134 Federal (2d) 875, had held that

a delivery of securities through the mails after the securities had been paid for, was a sufficient use of the mails to allow recovery under Section 12(2).[6] Since it was part of the arrangement that the plaintiffs-respondents, in addition to receiving Warranty Deeds, guarantee title policies and care contracts from the defendants through the mails, were to receive and did receive through the mails, statements which induced additional investments in the property, which statements included false and misleading reports of care and management, it was felt that jurisdiction did lie in the Federal Courts under the Securities Act, and that this was the most effective and complete relief available to the plaintiffs-respondents.

1. Section 12(2) does not require that the false statements concerning the security sold be transmitted through the mails.

Petitioners assume in their argument that the false and fraudulent statements inducing the purchase must be transmitted by some means of interstate commerce before there can be any liability under Section 12(2). This requirement is simply not contained in the wording of the statute, and may only be placed there by implication. As we shall show below, the complaint does allege the transmission of false and fraudulent information through the mails by way of the fraudulent and false statements for care and reports on care that had been given the property. It is easily demonstrated that this section does not require that the false state-

[6] The District Court in dismissing the complaint recognized that Plaintiffs had read this case right, stating "There is authority for both views". (R. 42).

ments be transmitted through or by means of interstate commerce.

Section 12(2) of the Securities Act as finally passed by Congress, while not a model of draftmanship, clearly applies to the case at bar. In order for it to be applied as Petitioners urge requires more to be read into it than is required by the interpretation and application made by the Court below. Nor is the application sought by Petitioners in keeping with the intention of Congress as expressed in the entire Security Act.

Boiling the problem down to its simplest point, the question is, do the false and fraudulent oral statements inducing the investor to make his purchase, have to be transmitted by interstate telephone or radio, before the relief given in Section 12(2) can be used by investors who have been defrauded? We think not.

The Section as construed by the Court below reads as if the word "and" were implied between the second and third clauses, as follows:

> Any person who—
>
> (2) sells a security — by the use of any means or instrument of transportation or communication in interstate commerce or of the mails *(and)* by means of — oral communication which includes an untrue statement of a material fact — shall be liable, etc.

This interpretation is the most natural and logical application of the Act, and prohibits the use of the mails at any stage of the transaction.

In order to construe the section as urged by Petitioners, it is necessary to imply much more than

this into the language used by the Congress. The language used does not state that the false oral communication must be transmitted in interstate commerce, so to arrive at the interpretation urged by them it is necessary to imply the following:

> Any person who—
>
> (2) sells a security — by the use of any means or instrument of transportation or communication in interstate commerce or of the mails, by means of — oral communication *(transmitted by said means or instruments of transportation or communication in interstate commerce or of the mails)*, which includes an untrue statement of a material fact — shall be liable, etc.

The construction urged by Petitioners is possible only if Section 12(2) is isolated from the other anti-fraud provisions of the Act and is not read as a part of the overall plan. It would eliminate any actions based on the ordinary "oral communication", and by the simple process of avoiding telephone conversations or radio messages across State lines, the confidence men and swindlers can and will avoid any liability under the securities act, although they are and will be using the U. S. Mails to transmit all of the documents, contracts, deeds, etc., evidencing their transaction. Such a construction would imply a Congressional intent to pave the road for the confidence man and swindler by setting up a legal way in which their activities could be carried on with the full use of the Post Office Department and all its facilities.

Petitioners assume in their argument that the mails have to be used *before* the investor has been induced to sign on the dotted line, or part with his

money, in order for Section 12(2) to apply. In other words, if the seller can get the investor to part with his money or sign a purchase money note without using the mails, then any subsequent use of the mails in consummating the deal is not a part of the definition of "sells". They then discuss the fact that Section 5 of the act provides both for a "sale" and for "delivery after sale", and that since Section 12(2) does not provide for "delivery after sale", that it cannot be read into the definition.

We believe this is wrong. Section 12(1) provides a remedy for any violation of Section 5. Section 5 (a) (1) provides a penalty for the sale of a security, and Section 5 (a) (2) provides a penalty for the delivery of a security after sale. If the word "sell" in Section 12 does not include delivery after sale, then Section 12(1) would only apply to violations of Section 5 (a) (1) and would not cover Section 5 (a) (2). We do not believe that this was intended by Congress, and certainly under the definition of "sale" in Section 2(3), "delivery after sale" would be included and govern the definition to be used in Section 12(1) and (2).

The Second Circuit in Schillner vs. H. Vaughan Clarke, 134 F. 2d 875 fully discussed the statute involved, and stated:

> "In the case at bar the contract of sale was concluded orally and the stock was paid for by the buyers without any use of the mails, but the mails were used for delivery of the stock certificates to the buyers. In our opinion such a transaction falls within both the letter and purpose of the statute. Section 2(3) of the Act, 15 U.S. C.A. Sec. 77b (3) provides that "unless the con-

> text otherwise requires" the term "sale" or "sell" shall include every contract of sale or disposition of * * * * a security or interest in a security for value". Delivery of the stock certificate pursuant to a contract of sale would seem to be a "disposition of * * * * a security" within this defination; consequently the seller who mails the certificate to the buyer "sells a security * * * by the use * * * of the mails".

The complaint in this case in addition to the allegations concerning the misrepresentations and fraud inducing the original purchase of the land, trees and care contracts, also alleges the mailing of statements for care expended on the "investment" together with reports of what had been done by the Defendants. These statements contained false reports as to what had been done, and that good irrigation water had been used on said trees, when such water was neither used by the Defendants or available to them for use. (R. 13). These additional mailings were the inducing cause of a further or continuing investment by Respondents in the "security" or "investment contract", and are in the nature of "prospectuses". Certainly if the true facts had been contained in such statements and reports, the Respondents would not have invested any more money in the property.

Petitioners briefly mention the Schillner case and argue that the Security Act was aimed only at Securities Sales in interstate commerce, and that the construction of the statute by the Court in that case was as though it were adopted by a local government rather than a federal government. We need not emphasize to this Court that the purpose of the

Securities Act was to *stop fraud* in the sale of securities, and that the required use of interstate commerce facilities was merely a necessary jurisdictional prop, and not a barrier to the Courts in *stopping such fraud.* The Schillner opinion is in keeping with the purpose and intent of the act, is justified by the wording of the statute, and will deter, if not prevent, the perpetration of fraud in future security transactions.

At the time the parties (Pummill and Respondents) affixed their signatures to the sales contract in the "face to face" transaction, so cherished by Petitioners as excusing them from compliance with the Securities Act, there was much yet to be done to deliver to the purchaser what the purchaser had bargained to receive. Under no stretch of the facts could physical delivery of the deed even give purchaser title to the land described therein, when the mortgage of Petitioners, (which under Texas law is superior title), was still against the property. The Purchaser was making a continuing investment in land, trees, and care and management. By what magic is the deal closed until he has his trees planted, and a caretaker in charge? Even accepting Petitioners' elusive logic that the deal is closed when the selling company gets the purchaser's money or property, seller's right to retain the money paid for planting land to trees does not mature until the trees have been planted. In the meantime, while this executory state of affairs exists between buyer and seller, the uses of the mail here involved take place, with the exception of the use to transmit statements for care of the trees, which statements precede and induce additional investments. The investor (Re-

spondents) bargained for a producing citrus grove as a part of a uniformly developed 800-acre tract, to be developed over a five year period. Can the deal in fact be considered closed until a five year period of the care contract is up, and the investor has received in full the subject matter of his original bargain paid for in part at the time, and in part over the five year period, based upon statements for care and expenses transmitted through the mails during such continuing period of investment?

(2.) Petitioners interpretation of Sec. 12(2) would throw it out of alignment with other sections of the Securities Act.

If it is held that the misrepresentations or fraudulent statements must be sent through the mails, then the Defendants herein might be liable for a criminal offense under the Act and yet not be liable civilly. Section 17 (a) (2) makes unlawful the types of misrepresentation and fraud set out in the complaint in this case, and the only requirement for use of the mails is that it be used at some point in the transaction. Set out below are some of the examples of mailings that have been held sufficient.[7] It is evident that the use of the mails is required only to give the necessary jurisdictional basis for the Federal Courts to act.

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[7] Mailing of reports among the Defendants reporting the success of meetings held to obtain money from victims, and remitting the proceeds. U.S. v. Monjar, 47 F. Supp. 421, aff'd, 147 F. 2d 916 (C.A. 3, 1944), cert. denied, 325 U.S. 859 (1949).

Delivery by mail of stock certificate after sale by oral representations. S.E.C. v. Wimer, 75 F. Supp. 955.

Mailing of warranty deeds between defendants, and to the county clerk for recording and delivery to investor. Mansfield v. U.S., 155 F. 2d 952 (C.A. 5, 1946), cert. denied, 329 U.S. 792 (1946).

Mailings acknowledging part payment and transmitting deeds. U.S. v. Earnhardt, 153 F. 2d 472 (C.A. 7, 1946), cert. denied, 328 U.S. 858 (1946).

There is nothing in the wording of Sec. 12 (2) or elsewhere in the Act to indicate that Congress intended to limit jurisdiction as to this provision, or make it more narrow than the other anti-fraud provisions of the Act. It is also evident that the purpose of the entire statute is to afford broad pratection to investors, and the statute being remedial in nature, should be construed to achieve that purpose.

Referring again to the Howey case, this Court at Page 301, in rejecting the theory that an investment must be speculative before it constituted an investment contract under the Act, stated:

> "The statutory policy of affording broad protection to investors, is not to be thwarted by unrealistic and irrelevant formulae".

The Fifth Circuit followed this policy in the decision below, and there is certainly no less reason for protecting investors today than there was in 1946, when the Howey case was decided.

II. Investors Will Lose A Large Part of the Protection Afforded By The Statute Under Petitioners Interpretation

We take issue with Petitioners on their statement that there is no question of the protection of investors involved here. Assuming that it is held that no private action will lie under Sec. 17 (a) of the Act, then the investors are restricted to Sec. 12 of the Act. Further assuming that the registration provisions of Section 5 are complied with by the promoters, then they could make any use of the mails they desired so long as they didn't transmit any false statements in the mails, and didn't engage in any "sales" talk by long distance phone or radio across state lines.

This, in our opinion, would assure the swindlers and confidence men of success in their operation, because it is common knowledge that the greatest swindles of all are effected by the "glowing pictures painted by the silky tongue of the confidence man". In other words, by "oral communication in a face to face transaction".

Petitioners view would allow these men to send through the mails to investors invitations to visit the Clubhouse, and evidence of the visit after their return to their homes without fear of civil liability. We do not think this was the purpose for which the Securities Act was passed. We do not read into the Securities Act a Congressional intent to set the swindler and confidence man up in a Garden of Eden, with only one forbidden fruit: use of mails to transmit the false representation or information.

Petitioners further argue that the Plaintiffs have full and complete protection under the Texas Blue Sky Law. We respectfully submit that the Texas Act provides only for actions against the Seller, has no provision covering the persons controlling the Seller,[8] and requires a much stronger burden of

[8] As is alleged in the complaint, and as will be shown at the time of trial, Petitioners operate through insolvent selling corporations. In this case, they used Pummill Development Company, a $1,000.00 corporation, which corporation they put $100,000.00 in the hole when they conveyed the 800-acre tract in question to such company, with no down payment, reserving a mortgage for $100,000.00 in excess of the value of the land. A judgment against Pummill Development Company, under such circumstances, would be worthless. Petitioners, with their mortgage, could and would wipe Pummill Development Company and all its assets off the face of the earth right under the auctioneer's gavel, should a successful plaintiff seek execution under such a judgment against the selling company alone. Consequently, Petitioners, who stand behind and take the bulk of the money out of the selling operations, and control it from a position of simulated remoteness, must be made parties to the action. This so complicates the suit as to almost price justice out of the market to the defrauded investor (under Texas law). The Securities Act, (Section 15) has provided for reaching those who control the Sellers, thus giving them

proof on the part of the Purchaser.

Counsel for Petitioners also state that counsel for Plaintiffs-respondents have had other cases involving Petitioners in Federal Court based on diversity of citizenship and that in those cases relied on the Texas Common Law of Fraud.[9] This is admitted, but the reason the Securities Act was not mentioned was that the Plaintiffs in those cases made their arrangement for care with third parties and hence the test of an "investment contract" as established by this Court in the Howey case was not met.

Under Article 4004 of the Revised Civil Statutes of Texas, a defrauded purchaser is allowed to recover the difference between the value of the property sold as it actually existed, and as it would have been if it had been as represented. This is an inadequate remedy, because in the instant case the complaint alleges that the actual value was $100.00 per acre, and the Petitioners, to lessen their damage would argue that if it had been as represented, it

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some hope in financing their actions, as well as the outcome. From our point of view, instead of Respondents reading some cases, and pleading themselves into Federal Court, the Petitioners, in backing off from the Texas Blue Sky Laws and Common Law of Fraud, backed into the Securities Act of 1933.

[9] Petitioners' brief makes frequent reference to the fact that Counsel for Respondents have represented other plaintiffs against petitioners, wherein violation of the Securities Act was not alleged as the basis of Federal jurisdiction, implying that the purpose of such pleading is to invoke Federal jurisdiction. Thereby Petitioners invite, if not provoke, a statement of the whole facts by Counsel for Respondents. Of twenty-five cases wherein Counsel for Respondents have represented Plaintiffs against Petitioners, nine plaintiffs were residents of Texas at the time of both the sale and the filing of suit, and their cases filed in the State Courts; three were residents of other states at the time of sale, but were residents of Texas at the time of the suit, and their suits were filed in State Courts; one was a resident of another state at the time of the sale and filing of the suit, and his suit filed in the State Courts; and twelve were residents of other states, and their suits filed in Federal Court based on diversity of citizenship. The residence of these plaintiffs as of the time of the sale was: Iowa, 6; Indiana, 1; Ohio, 3; Minnesota, 1; California, 1; Tennessee, 1; Oklahoma, 2; Illinois, 1; and Texas, 9. This indicates no tendency to invoke Federal jurisdiction on trivialities, as well as illustrating the interstate nature of Petitioners' operations.

would only have been worth $200.00 per acre. The purchasers actually expended $400.00 per acre for the land, plus the cost of the trees and care. Under the Security Act of 1933, the purchasers are entitled to a return of all of their purchase money, which is certainly more relief than is provided by any action available in the State Courts, with the exception of course, of complete rescission.

Under Petitioners' interpretation of Section 12 (2), it would make no difference whether the Purchaser of a security lived in New York or California, as long as the promoters did not actually transmit the misrepresentations through interstate commerce prior to obtaining his signature on the purchase agreement, regardless of how many falsehoods were related orally in inducing the purchase in the "face to face" transaction. In that event, his only remedy would be under State Laws, and he would be denied any relief under the Securities Act, irrespective of the use of the mails in consummating the deal through delivery of the securities.

III. The Ruling Below Does Not Extend Federal Jurisdiction But Follows The Intention of Congress to Suppress Fraud in Security Transactions:

Petitioners complain about a recent ruling of the 9th Circuit Court in which a promissory note was held, under the definition of a "security" in Section 2(3) of the Act, to constitute a security. An examination of that case shows that it was a criminal prosecution under Section 17 (a) (1) of the act, and that it involved a plan or scheme to defraud under which the Defendant was extracting sums of money by fraudulent means from a large number of people,

and giving worthless promissory notes in exchange therefor. Fear is expressed by the Petitioners that if the decision below is allowed to stand combined with the finding that a note is a security, next door neighbors who fall out over a land deal would immediately drop their papers in the mail box and rush into the nearest Federal Court.[10]

Respondents' answer that, in the first place, the ordinary transaction involving promissory notes is handled on a personal basis, and is not dependent on the mails for its successful consummation. In the second place, if fraud is involved in the sale of an instrument which is a "security" under the definition of the act, and such instrument is transmitted through the mails or by some other means of interstate commerce, then Congress gave that individual a right in Federal Court, and the Courts will just have to put up with him.

Respondents are not unsympathetic with the overworked Judiciary, but reject the idea that it ever has been, or ever will be the attitude of our Courts to avoid doing justice merely because of the hazards of overwork which might result from the influx of others likewise seeking justice. Petitioners overlook the fact that a clear cut decision hitting a fraudulent operation a mortal blow, quite often eliminates future similar work by eliminating the evil.

Petitioners further imply that the Securities Act should be broadly construed where the S.E.C. and

[10] Actually, the Courts are quite competent to protect themselves against the possibility of neighbors taking local squabbles into Federal Court. Petitioners hold before the Court the picture of a Federal Judiciary entangled in a mass of neighborhood squabbles, but the cases they cite as tending in this direction seem, in each instance, to involve the culprit who was operating a fraudulent scheme of interstate proportions, though the false representations were made face to face.

the Attorney General are concerned, but that private litigants, lacking the discretion of Governmental Agencies and Officers, should be restricted. This argument is untenable, for the sole purpose of the Securities Act is to protect the investors, the persons who pay the salaries of the enforcers of said Act. If they are to be protected, a double standard of interpretation is not the solution.

IV. Congressional Purpose is Served by the Construction of The Statute Adopted by the Court Below

Quotations from one or more legislators adverse to any worthwhile legislation are always available. But the overall, prevailing legislative intent is best determined by a common-sense application of the language they approved as a body to the purpose they intended to accomplish. The Federal Judiciary has said much about the purpose and intent of the Securities Act. Every expression of the judiciary concerning the Act has been that *the purpose was to stop fraud in the sale of securities.* The previously quoted statement of this Court in the Howey case was in keeping with the statement in S.E.C. vs. Joiner Leasing Corp., 320 U.S. 344, at 350-351, concerning statutory construction:

> "Some rules of statutory construction come down to us from sources that were hostile toward the legislative process itself and thought it generally wise to restrict the operation of an act to its narrowest permissible compass. However well these rules may serve at times to aid in deciphering legislative intent, they long have been subordinated to the doctrine that courts will construe the details of an act in conformity

with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits so as to carry out in particular cases the generally expressed legislative policy".

There is no clearer case for the application of the above doctrine than in the interpretation of Section 12(2). That the holding of the Court below is in keeping with this doctrine, and the expressed legislative policy of Congress, cannot be denied.

V. Jurisdiction for Private Relief Under Section 17 (a)

The Petition for Certiorari was granted on Section 12(2) of the Securities Act. However, Plaintiffs in the original complaint based jurisdiction also on violation of Section 17 (a). The trial Court, having held that the Complaint did not allege the sale of a security as defined by the Act, and that no use of the mails under Section 12 (2) had been alleged, did not rule on the relief sought under Section 17(a). The Circuit Court, having reversed the Trial Court on both of the findings so made, and remanded for trial, did not rule on Section 17(a). Plaintiffs are now in the position that if this Court should reverse the Circuit Court on Section 12(2), without passing on the relief available under Section 17 (a), the Complaint would be dismissed although under the ruling of the Circuit Court the sale of a Security was involved. Therefore, in order that Justice may be done, Plaintiffs-Respondents here, respectfully submit that it is necessary that this Court also rule on the alternative relief available to them under Section 17(a).

It is basic tort law that a person who has been injured by the violation of a statute intended for the protection of a class of which he is a member, may maintain a civil action for private relief. This is true unless the statute itself prohibits such an action, or unless there is other provision made for redress which is not inconsistent with the rule. This rule has been followed in allowing private actions for the violation of provisions of the Securities Act of 1934.

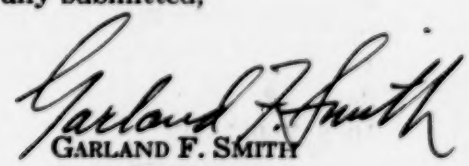
In Osborne v. Mallory, 86 F. Supp. 869 (S.D.N.Y. 1949) the court in discussing Section 17 (a) expressly stated that the investor had an implied right of action for the violation of Section 17 (a). It is therefore respectfully submitted that the instant Plaintiffs have a right to maintain this suit for their damages under Section 17(a) even if it is held that they do not have such right under Section 12(2).

CONCLUSION

The legislative intent, the language of the statute, and the holdings of the Courts relied upon by Respondents are all consistent with a cause of action in Respondents as pled here. The transaction was not complete at the time of the use of the mails, and if so, the use of the mails here involved is so integral a part of the transaction as to bring the matter within the Securities Act. The remedy afforded by local law is not adequate, and if it were, such fact would not deprive Respondents of the benefit of the Securities Act. The decision below does not extend federal jurisdiction, but pursues the common sense meaning of the Securities Act. Careful interpretation and enforcement of the Securities Act will greatly reduce

the dockets of federal courts by eliminating the evil of fraudulent sales of securities, whereas interpretation permitting use of the mails at all phases of the transaction except in transmitting the false matter, will through uncertainty give rise to more litigation, and fall short of accomplishing the legislative purpose to prevent fraud in sales of securities. The judgment of the Court of Appeals should be affirmed with directions that the case be remanded to the District Court for trial in accordance with such opinion of the Court of Appeals, and such additional direction as this Court shall deem proper.

Respectfully submitted,



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APPENDIX

Section 2 (3) of the Securities Act of 1933 (15 U.S.C. Sec. 77b (2)) reads as follows:

> Sec. 2 (') The term "sale", "sell", "offer to sell", or "offer for sale" shall include every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value; except that such terms shall not include preliminary negotiations or agreements between an issuer and any underwriter. Any security given or delivered with, or as a bonus on account of, any purchase of securities or any other thing, shall be conclusively presumed to constitute a part of the subject of such purchase and to have been sold for value. The issue or transfer of a right or privilege, when originally issued or transferred with a security, giving the holder of such security the right to convert such security into another security of the same issuer or of another person, or giving a right to subscribe to another security of the same issuer or of another person, which right cannot be exercised until some future date, shall not be deemed to be a sale of such other security; but the issue or transfer of such other security upon the exercise of such right of conversion or subscription shall be deemed a sale of such other security.

Section 5 (a) and (b) of the Securities Act of 1933 (15 U.S.C. Sec. 77e) reads as follows:

> "Sec. 5 (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security registered under this title, unless such prospectus meets the requirements of section 10; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of section 10."

"Sec. 13 of the Securities Act of 1933 (15 U.S.C. Sec. 77m) reads as follows:

Sec. 77m. Limitation of actions

No action shall be maintained to enforce any liability created under section 77k or section 77 1 (2) of this title unless brought within one year after the discovery of the untrue

statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77 1 (1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or section 77 1 (1) of this title more than three years after the security was bona fide offered to the public, or under section 77 1 (2) of this title more than three years after the sale.

Sec. 15 of the Securities Act of 1933 (15 U.S.C. Sec. 77o) reads as follows:

Sec. 77o. Liability of controlling persons

Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more persons by or through stock ownership, agency or otherwise, controls any person liable under sections 77k or 77 1 of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 423

LLOYD M. BENTSEN, SR., ET AL., *Petitioners,*

v.

EMERY C. BLACKWELL, ET AL., *Respondents.*

REPLY BRIEF FOR PETITIONERS

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March, 1954.

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IN THE

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No. 423

LLOYD M. BENTSEN, SR., ET AL., *Petitioners,*

v.

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REPLY BRIEF FOR PETITIONERS

The main issue is joined clearly by the briefs already filed in this action. Petitioners contend that in Section 12(2) of the Securities Act, Congress did not intend to govern face to face local securities transactions wherever the mails were used incidentally, as here, to deliver evidence of a previously concluded sale. Respondents and amicus curiae on the contrary say the Act was intended to apply in such cases. Petitioners contend that the Act contemplated an approximate accommodation between local and national matters allowing local transactions to remain within the competence of the states to be handled under state authority, and extending federal power and jurisdiction only to cases which seemed of national consequence. We believe

that the language of the statute and its history establish that the Congress was proceeding with an intention to limit federal jurisdiction so that it was not exercised "beyond the need of public protection". H. Rep. No. 85, 73d Cong. 1st Sess. p. 7. We do not suggest that the line was drawn as sharply as it might have been drawn today, for constitutional problems had their effect upon the scope of the Act (See Pet. Br. pp. 23, 24). But the objective of the statute is, we submit, clearly one based on the federal nature of our governmental system.

The language of the section requires the petitioner's suggested construction and the purpose of the statute will be advanced by such a construction.

I. PETITIONERS' CONSTRUCTION IS REQUIRED.

a. *Section 17 (a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 are not analogous.* The amicus brief argues that Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act have language which does not require as close a connection between the subject matter of the section and the use of the mails as does Section 12(2) here involved. From this premise, they argue the dubious conclusion that Section 12(2) should be construed as though its concededly different language is identical with those other sections. Of course, this argument ignores the fact that the sections are differently phrased. It also ignores the fact as pointed out in our main brief (pp. 14, 15) that the sections have different purposes and that the policy considerations are different. It takes no account of the fact that this Court has never construed the other provisions mentioned so broadly as is contended for in the present case. Indeed, even the lower court opinions on the other sections mentioned do not support respondents' position. No assistance in construing Section 12(2) can be obtained from a consideration of Section 17(a) of the 1933 Act or Section 10(b) of the Securities Exchange Act of 1934.

(1) Amicus curiae is aware of the substantial difference in language between the Sections now urged to be parallel. It has even on other occasions urged on the courts a position contrary to that urged here. Thus it has persuaded the Ninth Circuit Court of Appeals to adopt the position that the sections now urged to be parallel should be construed without regard to Section 12(2). In response to the Commission's urging as amicus curiae, that Circuit, in *Fratt* v. *Robinson*, 203 F. 2d 627, 634 (CA 9 1953), comparing Section 12(2) and Rule X-10B-5 under Section 10(b) of the Securities Exchange Act of 1934, said:

> "The applicable statutes are different in the two cases, as will be seen readily upon comparing them. While it may be that the fraudulent acts must appear in the use made of the instrumentality under § 12(2) of the Securities Act of 1933, under the Securities Exchange Act of 1934 the use need only be 'in connection with' the fraud."[1]

(2) The amicus brief here abounds with statements that petitioners do not deny that this transaction would be covered by Section 17(a) of the Securities Act (e.g., pp. 10, 14). We do deny it. We make no such concession. We had not felt it necessary to argue the point because the language of Section 17 is different, the form of legal action contemplated is different and the policy considerations are different (Pet. Br. pp. 14, 15). But certainly there is no substance to the argument that Section 17(a), or even the more broadly phrased Rule X-10B-5, would apply in the present situation. We have pointed out that this Court has ruled that even the inclusive mail fraud statute would stop short

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[1] Thus the SEC's amicus brief in the Ninth Circuit, in *Fratt*, stated, e.g., at pp. 68, 69: "But the question as to the proper interpretation of Section 12(2) of the 1933 Act is not before this Court.

"The different language of Rule X-10B-5 does not give rise to such a controversy . . ."

"Section 17(a) of the 1933 Act, upon which the Rule [X-10B-5] is patterned, contains similar language."

of a case where as here "the investor's money [was] taken in face to face negotiations."[2] See *Kann* v. *United States*, 323 U.S. 88 (Cited in Pet. Br. p. 15).

The Commission cites a number of District and Circuit Court cases. Certainly no lower court cases should have any weight in this Court. Further, the lower court cases cited by the Commission and the respondents do not support the position claimed by them. There is not a single Court of Appeals case in which it has been held or even stated that delivery of securities after sale is a violation of Section 17.[3] Indeed, it seems that so far as the lower courts are concerned, the respondents are in as good a position under Section 12(2) itself as under the other provisions claimed to be analogous. In any event argument

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[2] The quotation is from p. 6 of Respondents brief.

[3] The cases cited in footnote 20 on page 24 of amicus brief and note 7 of respondents' brief are primarily mail fraud cases. The three Court of Appeals cases cited, for example, are cases of appeals from convictions under the mail fraud statute coupled with Securities Act or conspiracy counts. The cases contain no discussion of the language of Section 17.

Thus, *United States* v. *Earnhardt*, 153 F. 2d 472 (CA 7 1946) was a case of conviction on eleven counts of mail fraud, Securities Act and conspiracy. The opinion discusses exclusively the mail fraud statute and there is not a single word of discussion of Section 17.

Bogy v. *United States*, 96 F. 2d 734 (CA 6 1938) was a case involving an appeal from a conviction under five counts of violation of the mail fraud statute and a sixth count alleging conspiracy to violate the mail fraud statute and the Securities Act. There was no substantive Securities Act count. The case contains some slight discussion of Section 17 and although the facts are meager they indicate that the mails were used to obtain surrender of securities owned by a customer. Certainly the case did not involve a delivery after sale.

Mansfield v. *United States*, 155 F. 2d 952 (1946), also a mail fraud case, is from the Fifth Circuit which decided the instant case below. Although it may therefore be assumed that court would decide as the Commission has indicated, the opinion cited contained no discussion of the language of Section 17(a) or its requirements concerning the relationship of the use of the mails to the scheme to defraud or to the sale of securities.

by analogy is treacherous unless the parallel and the result are both clear. Here neither is. The question under 12(2) is not illuminated by consideration of the differently phrased sections mentioned.

b. *The legislative history has been misconstrued by amicus.* Amicus seeks to construe the legislative history as favorable to its view by asserting that the Senate due to "preoccupation" made an inadvertent "omission" of jurisdictional language in the Senate bill (Br. pp. 29, 30). The purpose is apparently to suggest that the Congress regarded the jurisdictional allegations of Section 12(2) as non-essential and they should therefore be construed as though they had not been inserted in the statute. The argument misconstrues the legislative history. The Senate bill deliberately and not by omission contained no jurisdictional language because that bill provided for civil liabilities only in the case of securities registered with the SEC under the Act. Jurisdiction in such cases, as in Section 11 of the Act as passed, was based upon the filing of the registration statement. Section 9 of the Senate Bill quoted *in part* in the amicus brief (Footnote 29 of page 29) gave a right of recovery to every person acquiring any security by reason of misrepresentations made in the distribution of "such securities", i.e., securities covered by a registration statement filed with the SEC. This is made clear when the previous two sentences of the Senate bill are read with the part quoted by the Commission.[4]

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[4] Section 9 of the Senate bill began as follows:

Sec. 9. Every person acquiring any securities specified in such statement and offered to the public shall be presumed to rely upon the representations set forth in the said statement. In case any such registration statement shall be false or deceptive in any material respect, any person acquiring any securities to which such statement relates, either from the original issuer or from any other person shall have the right to rescind the transaction and to obtain the return, either at law or in equity, of any and all consideration given or paid for any such securities

When the House Committee considered the matter, it determined that in addition to a section dealing with securities registered under the Act, it needed another section covering securities not so registered. It also considered that cases in which the misrepresentations concerning registered securities were not contained in the registration statement belonged more properly in the latter section. The House Committee therefore separated these problems in two sections, the present Section 11 dealing with misrepresentations in a registration statement, and Section 12(2) dealing with representations which might not be contained in the registration statement. In the case of false statements in the registration statement no jurisdictional language was used (§ 11), but in the other class of representations the Committee adopted the very careful jurisdictional basis which is now in Section 12(2).

The statute explains itself more readily if we assume Congress knew exactly what it was doing in providing a jurisdictional base for Section 12(2), rather than the contrary view, which is, as we have seen (Pet. Br. pp. 18) basic to the position of the respondents and amicus curiae.

c. *Means of transportation are appropriate means of carrying communications as well as securities.* Amicus mentions the fact that Section 12(2) talks about a *means of transportation* or communication in interstate commerce. Presumably, the point suggested, though not stated, is that

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upon the surrender thereof, either from any vendor knowing of such falsity or from the persons signing such statement, jointly or severally.

It is then followed by the sentence quoted by amicus as follows:

Every person acquiring any security by reason of any false or deceptive representation made in the course of or in connection with a sale or an offer for sale or distribution of such securities shall have the right to recover any and all damages suffered by reason of such acquisition of such securities from the person or persons signing, issuing, using, or causing, directly or indirectly, such false or deceptive representation, jointly or severally * * *.

securities can be delivered through means of transportation but that communications such as prospectuses cannot. This is of course not the case. The many methods of transportation, e.g., by messenger, by rail or air express service, etc., are equally adapted to the transportation of securities and communications such as prospectuses. If any doubt could exist on this point, Section 17(b) of the Act sets it at rest. For that section contains a prohibition of use of the means of transportation in interstate commerce although it deals exclusively with communications and not at all with securities.[5]

d. *Section 12(1) is not analogous.* The respondent and the amicus urge that the distinction between "delivery after sale" and "sale" contained in the statute (Pet. Br. pp. 11, 12) is inapplicable to Section 12. They argue that otherwise Section 12(1) would not give a remedy for sale illegal under Section 5(a)(2) solely because the securities were delivered after sale by use of the mails. We do not know whether this construction would be unreasonable or not. The argument that Section 12(1) must be coextensive with Section 5 runs into seemingly insurmountable difficulty when it is recalled that Section 5(a)(1) prohibits not only sales but also an "offer to *buy*". 15 USC § 77e(a)(1) But if the context so "requires" the word "sale" in Section 12(1) can be construed differently from the definition contained in Section 2(3) of the Act. However, if the context of Section 12(1) requires that violence be done to a definition, it does not follow that the same violence should be done in Section 12(2), where the context does not so

[5] Section 17(b) prohibits undisclosed paid publicity for securities and makes it unlawful "by the use of any means or instruments *of transportation* or communication in interstate commerce or by the use of the mails, *to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which*, though not purporting to offer a security for sale describes such security for a" concealed consideration. 15 USC § 77q(b) (Emphasis supplied)

require. For the definitions contained in Section 2(3) are intended to apply in all cases, as the statute provides, "unless the context otherwise requires". Section 2, 15 USC § 77b.

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Amicus states (Br. p. 32) "In articles published shortly after passage of the Act, eminent authorities read Section 12(2) as did the court below," and cites articles by Douglas and Bates, by Frankfurter, and by Dean. The authorities are indeed eminent, but their articles are very far from supporting the bold statement made by amicus. Thus, one article contains no statement concerning the relation of Section 12 to the use of the mails at all.[6] Another merely contains a statement that "as a practical matter" "it will be safer" to construe the Act as applicable[7] and the third contains a most casual reference in a footnote.[8]

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[6] Justice Frankfurter's article, *The Federal Securities Act of 1933: II*, 8 Fortune 53, 108, states, referring to Section 11 of the Act "The rights against those responsible for the registration statement run in favor of all innocent buyers whether or not the purchase is made by the use of the mails or through channels of interstate commerce." We have found no similar statement in the article concerning the requirements of Section 12(2) with respect to the use of the mails.

[7] Dean, *The Federal Securities Act: I*, 8 Fortune 50 (1933).

[8] Douglas and Bates, *The Federal Securities Act of 1933*, 43 Yale L. J. 171 (1933), at page 183 in footnote 51 contains the following:

> "Civil liability under Section 12 would *probably* follow even though only part of the entire transaction was consummated in interstate commerce or through the mails. Thus solicitation of the sale through the mails or by interstate commerce followed by delivery of the security in a wholly intrastate transaction without use of the mails would probably be sufficient, *and vice versa*." (Emphasis supplied)

II. TEXAS LAW IS ADEQUATE TO PROTECT PURCHASERS.

The amicus curiae and the respondent both seem to be of the opinion, for different reasons, (*Cf.* Amicus Br., pp. 18, 19 with Resp. Br., pp. 20-22) that the Texas statute is not adequate to protect investors within the State. We assume that if this were the case it would under our federal system be a question concerning only the State of Texas and its citizens, such as petitioners and respondents here. We point out, however, that so far as the present case is concerned the complaint alleges affirmative misrepresentations and seeks a remedy i.e., cancellation and rescission, which concededly is available under the Texas securities law. Indeed, the present complaint alleges injury "both as a result of . . . violation of the Securities Act of 1933 and under the statutes of the State of Texas" (R. 15) and the same relief is requested against the same parties under the Securities Act of 1933 or "in the alternative" . . . "under the laws of the State of Texas" (R. 15-16). This prayer was of course refused by the District Court (R. 45).

We have also seen complaints filed by respondents' counsel in the state courts of Texas on behalf of other plaintiffs against other defendants but including also petitioners. The relief sought and the allegation in those complaints are almost identical with the allegations in the present complaint except for those few changes necessary to allege the existence of a security.[9]

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[9] See, e.g., *Schoon* v. *Bentsen, et al.*, No. B-17576, in the 93rd Dist. Ct. of Hidalgo County, Texas; *Whitson* v. *Bentsen, et al.*, No. B-18214 in the same court; *Bertelson* v. *Bentsen, et al.*, No. B-18327 in the same court, and *Meyer* v. *Bentsen*, No. A-8286, in the 92d District Court of Hidalgo County, Texas. Certified copies of these complaints will be lodged with the Clerk of this Court.

This disposes of respondents' argument that under Texas law a buyer cannot sue a person controlling the seller. (Rep. Br. pp. 20, 21)[10]

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There is so much mention by respondents of matters outside the record that we feel that a brief statement may be helpful in explaining to the Court the events which led to these actions. This is one of a series of similar lawsuits brought by the same counsel on behalf of different plaintiffs against different defendants. It was the first one to allege violation of federal law, the other actions being based on state law. The background facts are as follows:

The petitioners (the Bentsens) had for many years been in the business of sell real estate in the Rio Grande Valley. In connection with the sales of real estate, care contracts were frequently entered into. Some years ago for personal reasons the Bentsens retired from the real estate business although they still owned a good deal of acreage. A number of persons who had experience in real estate formed companies of their own to sell in the area. The Pummills, defendants in the present action, were one such group. There were many others, some of whom had been in business previously. The Bentsens sold land to these persons partly on credit, retaining a vendors lien to protect their rights. Each company conducted independent sales from the land which they had purchased from the Bentsens.

In January 1951 there was an unprecedented freeze in the Rio Grande Valley which destroyed approximately 80% of the citrus trees in the valley. Thereafter many purchasers came to the conclusion that the land

[10] In fact petitioners were not in control of the sellers. But respondents are equally free to allege that petitioners are liable under state or federal law, and equally unable to prove it in either case.

they purchased had been sold to them by misrepresentation. Counsel for respondents here were retained by a number of such purchasers from within and without the state. Actions were commenced against the defendants in the present action, the Pummills, and against other groups that had sold other pieces of land. The allegations were substantially parallel in all cases. In a number of these actions, stated by respondent to be twenty-five (Br. p. 21 n. 9), the Bentsen petitioners were joined on the theory that their vendors lien made them conspirators. As the respondents themselves indicate, almost all these actions were commenced in reliance on State law.

III. THE USE OF THE MAILS HERE IS NOT PART OF THE SALE.

The amicus and respondents argue that the delivery of the deeds and care contracts by mail is part of the sale and not a delivery after sale. This misconceives the nature of securities transactions and the nature of the present transaction. The complaint alleges (we believe contrary to the fact) that the transactions here involved are securities transactions. If so, it is concededly (Amicus Br. p. 6, 7) only because the Securities Act defines "security" to include an "investment contract". This Court in *SEC* v. *W. J. Howey Co.*, 328 U.S. 293, 298, 299, stated:

> "In other words, an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise."

The Court then held the sale of land and a care contract (there called a service contract) jointly amounted to an investment contract and that the respective shares in the common enterprise "are evidenced by land sales contracts

and warranty deeds, which serve as a convenient method of determining the investors' allocable share of the profits. The resulting transfer of rights in land is purely incidental." *Id.* 300.

Under this language, the investment contract is created and paid for in the face to face transaction in Hidalgo County, Texas. What follows thereafter is merely transmission of evidence of what has already taken place. It is not part of the sale. In securities parlance and the language of the statute (§ 5(a)(2), 5(b)(2), 15 U.S.C. § 77e(a)(2) and 77e(b)(2)), it is part of the process of "delivery after sale." Accordingly, the delivery of the deed, after recordation, through the mails and the transmission of the previously executed care contract through the mails was merely a delivery of evidences of what has already occurred.

Had they not been sent through the mails to the purchasers the status of the parties would have been the same. Amicus suggests (page 38, n. 38) that under Texas law delivery of a deed is necessary to pass title. This is true but it is also well established under Texas law that delivery of the deed occurred when the grantor had it recorded in the purchaser's name. See e.g., *Ford* v. *Hackel*, 124 Tex. 402, 77 SW 2d 1043 (1935); *Caldwell* v. *Tucker*, 246 SW 2d 923 (Tex. Civ. App. 1952). Plainly therefore the title deeds had been effectively "delivered" to the purchasers under Texas law before the mailing of the copies with notice of recordation upon which the complaint relies.

Translated to terms of the normal securities transaction the analogy is as follows:

A customer in a brokerage office in New York agrees to buy certain shares and pays for them. He receives immediately a confirmation that the brokerage firm has sold him so many shares at such and such a price and that payment has been received. The security is in such case normally not delivered for several days. It may be necessary to obtain signatures on the certificates to authorize

transfer . It may be necessary to register the shares in the purchaser's name (see the analogy of recordation of the deeds in the present case); it may be desired by the purchaser to have the shares in specific denominations which may not be readily available. These procedures take a few days and then the shares are sent to the purchaser, normally by registered mail.

The "sale" is concluded in the face to face transaction. What occurs thereafter is a mere incidental mechanical process described properly as delivery after sale.[11]

Such transactions in securities occur daily in all the financial centers of the United States. They are of the type which are in all aspects local, where purchaser and seller reside in the same community and where state law is adequate to protect the investor. To hold that the incidental delivery of securities after sale which takes place almost universally by mail is part of the sale and a ground for federal jurisdiction in civil actions would make the Securities Act the governing law in every local securities transaction.

IV. MISCELLANEOUS POINTS

a. The Care Statement Is Not a Basis for Jurisdiction.

It is argued by respondents here that statements for expenditures for care are parts of the sale of the security and that the care statements are "in the nature of prospectuses" (Resp. Br. p. 16).

The court below did not rely on these care statements restricting itself in its opinion to "delivery of the deeds and contracts". Nor does amicus support this position.

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[11] Cf. the published opinion of the General Counsel of the Securities and Exchange Commission that a securities transaction is completed "when the customer parts with value in connection with the transaction". Securities Exchange Act Release No. 253, May 31, 1953. This relates to Section 11(d)(2) of the Securities Exchange Act, 15 USC § 78k(d)(2) requiring confirmation "at or before the completion of the transaction".

It will be remembered that the care statements arose in the following manner. Under the care contract the purchaser set up a fund in a bank in Hidalgo County, Texas, upon which the care company, i.e., the Pummill Management Company, could draw. Monthly the management company sent the purchaser a statement of the funds which it had drawn and the purposes for which the funds had been expended. The purchaser under its care agreement was then obligated to replenish the deposit. These care statements were mere statements of expenditures. They were not as respondent states "in the nature of prospectuses" since a prospectus is defined in the Act as a communication "which offers a security for sale" Section 2(10).

The "investment contract" as we have seen had been previously created and "sold". The argument of respondent attempts to confuse the sale with subsequent transactions, under an analysis which would make the sale of the investment contract here a five year process (Resp. Br. p. 18)! Such a contention cannot be sustained in the light of the fact that the "investment contract" was as we have seen created and sold in the face to face transaction.

Indeed, the complaint makes this abundantly clear. For example, uniformly it is alleged that a particular plaintiff "did on February 24, 1950 purchase said securities and/or investment contracts . . ." The next sentence of the complaint begins "That *since the date of said purchase,* said Plaintiff has spent" an additional sum for care of the trees. See R. 3, 5, 6, 7, 8, 8-9, 9. This formulation is followed in every paragraph of the charging count (R. 3-10). It is then followed by a recitation (R. 10, 11) of the alleged misrepresentations but for which it is alleged, the respondents

"would not have made said investment." It then alleges that "after" the making of the investment the mails were used to forward the deeds, contracts and statements and that then the defendants "continued to make false representations by sending to Plaintiffs, through the United States mails, various care bills including therein charges for irrigation water which was neither used nor available to the Defendants for such use" (R. 11, 12).

The complaint clearly alleges that the "investment contract", was purchased and sold in each case on the specified date, and that the care statements were mailed only after the purchase and sale was completed.

b. Respondents Cannot Here Attempt to Argue That Section 17(a) Provides an Independent Basis for Civil Suit.

Respondents seek to argue that they have a civil remedy not only under Section 12(2) but also under Section 17(a) and that the language of Section 17(a) is broadly enough phrased to cover the situation even if Section 12(2) does not. We respectfully submit that this issue is not within the grant of the petition for certiorari, and that it was not even raised in the Court of Appeals. If so advised, the respondents if their complaint is stricken down by this Court, may seek to revive it by these desperate means in the District Court.

In any event, we point out how far fetched the respondents' contention is. It suggests that although Congress prescribed in specific terms a carefully defined remedy in Section 12(2) with specific relief and specified burdens of proof, it nevertheless in the same statute inadvertently created a different and independent remedy for the identi-

cal situation governed only by the law of illegal transactions.[12]

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[12] In this connection it should be noted that the statute of limitations (Section 13) was amended in 1934 to cut the period of limitations for action under 12(2). Certainly Congress could not have believed that a remedy existed under Section 17 which would not be covered by this limitation provision.

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